USAID PROJECT TO DEVELOP LAND AND REAL ESTATE MARKETS IN MOLDOVA

DATE: 10 December, 1999

TO: Stevan Dobrilovic

FROM: Richard Rumley

Subject: Final Status Report

This is my Final Report of the events, observations, and accomplishments having transpired during my approximate three month tenure in the Republic of Moldova and my recommendations relating to the future of the mortgage lending program. *(Please refer to the two previous interim reports for additional background and recommendations.)*

BACKGROUND

Since September 13, 1999, I have been residing in Chisinau working with the resident staff of Booz • Allen & Hamilton (BAH) and FinComBank S.A. (the "Bank") in a consultant capacity as the Mortgage Lending Technical Advisor. The concept of mortgage finance has recently been introduced and made legally possible in Moldova and my participation is the direct outgrowth of the agricultural land privatization project currently being directed by BAH. My mission was to provide technical support to the Bank and other related parties in structuring, underwriting, documenting and servicing purchase money mortgage loans. The Bank, via a joint funding program with the Citizens Network for Foreign Affairs (CNFA) is offering mortgage loans to qualified independent farm operators for the purpose of assembling and purchasing acceptable farm land parcels. It is recognized that lands need to be placed into the hands of individuals who can make the land productive and to generate an economic platform for the country. Many (e.g. pensioners, the infirmed, etc) who obtained their original land shares from the State have neither the desire nor ability to farm their properties. Farmers who are committed to staying in the business are desirous of acquiring ownership of additional properties but need a practical and affordable financing vehicle to implement their goals.

CURRENT PROCEDURE FOR LOAN ORIGINATION

There continues to be adjustments made for determining appropriate origination procedures. This element in the lending chain should not be viewed as a static process but as a flexible, progressive endeavor. The sophistication range of the borrowers vary widely - from simple peasant village farmers to well educated former business professionals who are now devoting their efforts to the agricultural sector. Attracting borrowers must originate from several sources including direct banking contact, print media, and word-of-mouth. It is my opinion that the least effective at this time is direct banking contact since the typical customer has no direct dealings with or trust of banks, banks do not have a well developed local branch system within the country, and, in my assessment, banks are not customer or marketing oriented. The most effective strategy will be word-of-mouth emanating from trusted local village sources. The ELS group should be a great conduit for disseminating information about the program since they are in regular contact with land buyers and sellers.

At this juncture, the Bank is primarily reliant on BAH to be the supplier of lending opportunities. Potential loan prospects are funneled through BAH to make a preliminary assessment prior to the Bank's involvement.

LOAN EVALUATION

The Bank's loan evaluation process is very thorough and has remained virtually unchanged during my tenure although additional elements pertaining specifically to agricultural credits and to unique regional challenges have been input into the equation. There is still some uncertainty in the process, however, because of untested concepts and a lack of history of mortgage lending. The credit evaluation process entails the following phases.

Interview and Application	Bank conducts an exploratory interview and the client receives a formal Application to complete along with a check list of information needed by the Bank
Information collection and review	Client submits completed Application and the required information. Need Business Plan, financial statements, data on collateral, business formation documents, title information, purchase and sale agreements, barter contracts, etc.
Site visits and appraisal process	Two individuals from the Bank make a joint site visit to the farm. (Appraisals will be ordered when qualified appraisers are available and the loan exposure justifies).
Loan underwriting and structure	Loan specialist reviews information and structures loan based on the needs of the client and the information furnished.

The evaluation process also includes the input and support of BAH's mortgage finance specialist, Ms. Doina Nistor. Ms. Nistor meets with and assists the customer; assesses the suitability of the loan request, the borrower and the collateral; conducts site visits; assists the client in preparing the Business Plan; and works consistently with the Bank and the borrower throughout the entire crediting process. In addition, she is actively gathering research data to make the underwriting and valuation process more meaningful. Without BAH's support, I believe that the program would not progress effectively.

PROPERTY VALUATION AND APPRAISAL

This process remains a significant challenge. No qualified agricultural appraisers are available in the country and no definitive and reliable data sources have been compiled to support the establishment of market values or to derive standard yield and expenses ratios. The Bank's Credit and Lending staff is now called upon to establish a collateral value. The Bank has started utilizing hypothetical values based on information being provided by borrowers and from information being captured by ELS. For instance, they are currently using a maximum hectare value of 5000 lei in northern Moldova as an upper limit underwriting guideline even if the Purchase and Sale Contract indicates a higher purchase price. This is an understandable precaution when there is no market support to suggest otherwise, but care has to be taken not to be arbitrary or else good loan opportunities might be missed. Conversely, suspicion as to a true market value arises when observing that when the borrower is acquiring multiple parcels, all parcels are often reported as being purchased at the same price. In any event, it does appear that land prices are trending upward as sellers become more aware of the potential value of the assets they own. I would like to see BAH devote additional resources to establishing databases that could be utilized in the property analysis process. Needed are reliable and accessible records of property sales transactions and data on farm operating performance. Use of the income approach to determine value is the most suitable approach based on data available, but more definitive income / expense data is needed as is support for determining reasonable capitalization rates.

The agricultural land valuation seminar conducted at BAH's request through the auspices of ACDI/VOCA, was a valuable and useful event. I believe that the participants, including the Bank's personnel, absorbed considerable practical information that is currently being applied in the analysis of agricultural lands. As such, the opinion of the Bank's staff concerning market value is perhaps as educated as any individual's at this time.

APPROPRIATENESS OF THE TERMS AND STRUCTURE OF COLLATERIALIZED MORTGAGE LOANS

Considering the nature of the credits, the terms and structure of the loans closed to date appear satisfactory. Loan terms do not exceed five years and are repayable under terms and conditions consistent with agricultural cash flow cycles. In addition, the loan is structured to insure that based on our analysis of the farm's projected cash flows, there should be more than adequate income generated annually to support the debt and to provide reasonable working capital. Our analysis generally employs an under estimation of yields (revenues) and an over estimation of anticipated expenses. Notwithstanding this, the success of our underwriting approach and loan structuring cannot be effectively tested until the program has been seasoned for two or three years. Future underwriting and structural "tweaking" may be required once a fair evaluation of the seasoned loans has been conducted. I have reviewed at least five loan packages and am satisfied that the credits have been underwritten and structured appropriately. A considerable amount of time and effort was expended by the Bank and by BAH from the loan's inception to closing.

DOCUMENTATION

The Bank's internally drafted loan documents are presently being used to document the loans. BAH has undertaken to draft suitable "standard" mortgage instruments that would be equitable, provide adequate protection for the Bank, adhere to current laws and practices, and be sustainable under court scrutiny. We have presented drafts of our documents to the Bank for their written comments. As of the date of this report, we have not received their response. In general, my impression is that the Bank's attorneys have pride of authorship in their work product and we are not going to receive material cooperation to implement changes. I understand the Bank's holds legal responsibility for any actions incurred under the documents so we must accede to their legal interpretations if we expect to hold them responsible.

Standardized documents are a desired target in that we would like to see documents useable and acceptable universally by other credit granting institutions who may later participate in the mortgage lending program. Document uniformity is an essential element especially if the same joint funding participants are involved, loan administration efficiencies are to be realized, and if some semblance of a secondary market is to be considered. Certain institutional customization may be acceptable upon confirmation of the modifications.

OPERATIONS

The loan process can involve considerable time and expense if done cautiously. Banks have a legal and moral obligation to reasonably evaluate the credit request and the borrowers should be prepared to understand this process. For this reason, most financial institutions will collect a loan fee from the borrower to off-set a portion of their expenses. A borrower can often expect to incur, in addition to a loan fee, appraisal expenses, credit report charges, documentation costs, and other third-party closing costs that the bank will expend. FinComBank does not charge the client any fees for its time and services. They do anticipate levying a small fee for small loans.

The Bank's mortgage loan crediting process absorbs a significant amount of time. Likewise, BAH devotes a substantial level of its resources during the process that would ordinarily fall to the Bank. Under the **Loan Evaluation** section in this report, the process is identified. I see no reason to try to radically minimize or streamline the process since the mortgage lending program is still in the pilot phase. The extra effort and time is viewed as an essential part of the learning process. Beyond the evaluation stage, there are the documentation and closing phases which also demand time and expense. As a part of the closing process, Bank personnel will accompany the borrower to the notary and TCO to have the Pledge Agreement notarized and registered. This procedure will hopefully be eliminated in the future but because of Moldavian laws and customs, it is best for the Bank to continue the practice. It serves to protect or assures perfection of the Bank's collateral interest and provides for timely funding of loan proceeds to the land sellers.

FUTURE NEEDS

The Bank / CNFA pilot program is a good foundation to address issues concerning borrower qualifications, collateral valuation, underwriting approaches, legal matters, documentation procedures, loan servicing, and the identification of other unanticipated factors.

To be effective in accomplishing the needs of the potential client base and to test the ultimate effectiveness of the program, the program must be expanded to include:

- Additional funding either under the existing CNFA umbrella or another conduit

- Greater lender participation through other commercial banks and / or through the local village based Savings and Credit Associations (SCAs).

The funds currently dedicated to the Bank / CNFA mortgage loan program are insufficient to make an impact on the needs of the community. I would like to see a minimum of $2 million made available to permit establishing an active loan test basis of between 50 and 100 loans from which to evaluate our underwriting criteria and the performance abilities of the borrowers. Due to the nature of the loans currently being underwritten under the CNFA Mortgage Loan Program (MLP), loan successes or failures cannot be evaluated for several years. This assessment will be further delayed if the number of loans are few. MLP loans generally have 5 year terms and long time spans between contractual repayment obligations (tied to agricultural seasons). Unless repayment schedules are tightened, we will only be able to see results on an annual basis as payments of principal and interest become due. With few loans to evaluate, it might take 3 to 5 years before portfolio patterns are detected. However, with a large number of loans to evaluate we should be able to identify the portfolio's strengths and weaknesses over the next two years, or agricultural cycles.

A larger distribution network is also needed to be able to target and service more customers. The program needs to have a participation arrangement with 3 or 4 financially stable banks, each having a branch network with loan production potential located throughout various regions of the Country. Loan origination and administration activities should emanate within reasonable proximity to the client base and their businesses. Presently, customers are often driving 2 to 4 hours each way in hazardous conditions to get access to the Bank. The entire loan cycle requires numerous trips of the Bank and the customer consisting of the initial interviews, application submission, initial site visits, document signing, document notarization and registration, and on-going follow up site and records inspections. This is a natural barrier for the bank and the customer.

Alternatively, or in conjunction to the commercial banks, SCAs are a potential delivery source. These credit facilities would be a source for providing low denomination loans which commercial banks tend to avoid. There are about 130 SCAs currently operating in villages throughout the country and these are already providing a variety of small, short term, farm related credits to their members.

SCAs are voluntary organizations that lend to and mobilize savings from their members and operate in a manner similar to Credit Unions. Members select their Board who then establish organization and lending policies.

Only a selected group of SCA's would be resourced initially based on our assessment of the local Board's capabilities. Extensive training in underwriting, collateral, land valuation, documentation, funding, collection, and servicing will have to be provided. The preferred funding conduit will also have to be identified and processes developed.

RECOMMENDATIONS AND TASKS TO BE COMPLETED

- Complete standard forms of mortgage loan documents and documentation procedures.
- Develop a Business Plan form that can be understood and prepared by the typical customer. BAH should be out of the Business Plan preparation business. This task is the responsibility of the borrower. Simple standardized forms could be developed to permit relatively unsophisticated borrowers the ability to understand and accurately provide the information requested. An exhaustive narrative Plan is not necessary although supportable cash flow projections are an essential component.
- **If other lender participants become involved** (especially critical if SCAs become involved):
  - Develop uniform training material pertaining to underwriting, documentation, valuation, legal requirements, collection, servicing, workouts, foreclosure, preparation of business plans and cash flow statements, working with notaries and TCOs, etc.
  - Structure a plan for distribution and collection of funds if conduit is other than CNFA.
  - Prepare a Mortgage Lending Manual incorporating training material. The manual should also include key references to the Pledge Law, Civil Code, Finance Code and other legal matters regarding real estate property, ownership, and mortgage finance.

- Complete development a database of land transactions into a format useable as a tool for assessing market values of farm lands under the sales approach.
- Collect and compile farm revenue and expense data to assist in valuing property under the income approach.
- Evaluate and recommend laws that impact mortgage lending activity, lender's rights and borrower's rights. Attention must be given to foreclosure procedures and streamlining the process. The Bank indicated that this is a major concern to them. The court system is not lender friendly. This must be given attention if the mortgage market is to work.
- Assist in the development of agricultural property valuation standards, and the training of qualified appraisers in this area This is integral component to the mortgage finance process.

OTHER RECOMMENDATIONS AND ISSUES

Moldova may be better served by incorporating the best of European mortgage finance and real property standards rather than those of the United States. The US legal and mortgage practice systems are too far developed and complex for use in this emerging country. Having a knowledge of various US practices is a definite advantage since it gives one a broad perspective on the many complex issues encompassing real estate finance, property ownership and property rights. I would like to see a manual or report compiled to encompass key provisions of mortgage and land laws and practices of suitable European countries such as Poland, Czech Republic, Romania, Germany, etc. These laws and practices would be evaluated and the better provisions incorporated into Moldovan practice. In my wrap-up discussions with the Bank, I was informed that an advisory group from the Netherlands (I believe) has contracted to work with the Bank early in 2000, and that mortgage finance will be an issue. BAH should follow up with the Bank on this matter.

One of the long term goalsof the task is to develop a secondary (liquidity) market for agricultural credits. I foresee this happening only if the primary market is first developed which means that –

- The banking system stabilizes and retail funds start to build up in savings.
- The currency stabilizes
- The government stabilizes and provides forms of mortgage insurance or guarantees
- There area sufficient pools of mortgages to attract investors (should be able to pool mortgages from several banks)
- The mortgage system has been tested for several cycles (i.e. 5 to 10 years)
- Agricultural and borrower performance has been tested
- Mortgage terms are extended - Investors prefer long term commitments. Pools of 1 to 5 year term mortgages with staggered maturity dates is not an attractive investment opportunity
- Payment schedules under the mortgages are more frequent. - Investors expect payments on their investments more often than annually. There must be a match between funds inflow and payments.
- Laws are established to support lenders and especially their ability to recapture collateral on a timely basis.

Unless prohibited by law, the banks my be able to establish pools of their own mortgages and provide performance and payment guarantees utilizing their own credit rating. This would by-pass traditional conduit arrangements.

RESOURCES NEEDED

I did not identify resources or responsibilities above since I am not aware of the current resources available or background level. I do, however, see the need for the following functions.

- Mortgage advisory support will continue to be needed.
- Training support is necessary.
- Research support to gather data needs to be found.
- Systems support is required to develop databases.
- Legal support is an absolute necessity. I do not know if current legal staffing is sufficient or if additional support is warranted.

USAID PROJECT TO DEVELOP LAND AND REAL ESTATE MARKETS IN MOLDOVA

DATE: 16 October, 1999

TO: Stevan Dobrilovic

FROM: Richard Rumley

SUBJECT: INITIAL OVERVIEW REPORT

Since September 12th, I have been working with FinComBank S.A. (the Bank) and the Booz • Allen & Hamilton's (BAH) Legal and Land teams in the capacity of a mortgage technical advisor. My primary function is to assist the Bank, where necessary, in developing an internal lending structure to facilitate providing purchase money and other types of mortgage loans to Moldovan farmers in support of the acquisition of agricultural land. The Bank is administering and contributing to a mortgage credit program established by The Citizens Network for Foreign Affairs, Inc (CNFA). The Bank's contribution is to provide 50% of the capital and to originate, evaluate, document and service the credits.

This report is a summary of my observations, findings and recommendations resulting from my initial 25 day tenure here in Moldova.

I. FINCOMBANK'S ORGANIZATIONAL STRUCTURE – Mortgage Lending

I have had the opportunity to meet with the various departments within the Bank who have a direct involvement with the mortgage lending program. The principal participants are:

CREDIT and LOAN DEPARTMENT

The Credit and Loan Department is responsible for procuring, underwriting, structuring , documenting and servicing the loan.

The Department consists of the,

- Chief Credit Officer
- Four Loan Specialists (Loan Officers)
  Specialists are assigned credits that mirror their backgrounds and skills. Two of the specialists have been selected to work on mortgage loans, in addition to their other responsibilities.

LEGAL DEPARTMENT

The Legal Department's principal function is to operate as legal advisors to the bank, corporately. In addition, are involved in the legal and documentation issues inherent with providing loans. With regard to the mortgage operation, they review and assist in the structure of loan documents and provide other legal assistance to the loan staff when requested. The Loan Department is principally responsible for the preparation of the documents.

II. LOAN PROCESSES

NOTE: The term "BUILDINGS & IMPROVEMENTS" in the following paragraphs refers to NON-LAND property, i.e. to Buildings and Improvements only. Until the implementation of Moldova's recent privatization laws, Land was the property of the State and could not be held in private ownership. The term "REAL ESTATE" herein means land and all improvements which is now consistent with the current Movdovan Law on Real Estate Cadastre .

The Bank has prepared and implemented extensive formal written credit policies and procedures for originating, evaluating and documenting many types of standard commercial and consumer loans. A copy of their Credit Policy Manual was translated for me after which I was able to review it in detail. In addition, I have had the opportunity to review loan and documentation files, to interview senior management, and to converse at length on numerous occasions with members of the legal, loan and credit staffs. Policies, procedures and their practices appear consistent with generally acceptable credit guidelines and normal commercial bank operational methodologies. The personnel involved in the lending and credit processes seem to be adequately trained in underwriting and analyzing a variety of standard business credits. Commercial loans collaterialized by BUILDINGS & IMPROVEMENTS have been utilized in the past so the Bank is experienced in embracing this type of collateral for the extension of credit. Appraisals of BUILDINGS & IMPROVEMENTS were conducted by outside independent appraisal companies and copies of their reports were found in the documentation files. It was also noted in the Bank's Credit Policy Manual that there is a program for granting loans for construction, reconstruction and renovation purposes. To the Bank's recollection, only one of these has been done. There are no policies specifically designated to traditional Mortgage Lending. It is my understanding that these are still in the development stage. I have also observed from my verbal discussions with the Bank, that they have no clear guidelines of how to structure such policies since this type loan product is unknown to them. To assist in this endeavor, I have prepared and given the Bank an outline incorporating the key elements which I believe should be covered in a mortgage loan policy statement, and I will be offering them, for an example, a copy of an actual Policy statement prepared for a commercial bank. Generally, I saw nothing negative within the Bank's internal structure that would impede their ability to develop a sound mortgage lending program. The only vague element is their uncertainty on how to underwrite and document traditional land oriented REAL ESTATE credits - farm lands in particular.

INTERNAL LOAN EVALUATION PROCESS

- **Loan Specialist conducts a pre-qualification interview** with the client to gather basic information about the customer, their business, financing needs and to discuss the Bank's lending issues and preliminary loan terms. Client is given an application and other forms (or formats) to complete or follow if there appears to be a mutual interest.
- **Client submits the completed application,** and furnishes all required support documents including personal history and background, financial statements, legal documents, collateral data, and a business plan. Information to submit is dependent on the loan type.
- **Analysis of data** by Bank's Loan Specialist
  Where REAL ESTATE is to be used as collateral, two bank personnel – loan/credit staff, attorney - normally visit the site and an independent appraisal is ordered from an outside appraisal company. Appraisals of farm lands are not requested since no qualified appraisers are available.

- **Loan Specialist underwrites** and structures final loan terms
- **Formal written loan submission** is prepared by the Loan Specialist and the approval process commences.(See LOAN APPROVAL PROCESS)
- **Documentation and funding** is the responsibility of the Loan Department who enlists the assistance of the Legal Department to review and draft loan documents
- **Collecting, Reporting and Servicing** Credit department stays involved throughout the entire life of the loan. Accounting is involved in the collection and reporting but the Credit Department receives regular reports in order to be able to monitor the loan progress. Any workout situations are handled by the Loan Department.

INTERNAL LOAN APPROVAL PROCESS

The loan approval process follows the same path irrespective of the amount or complexity of the loan. For small, simple credits, the approval process appears unwieldy. The process is followed, however, because the Bank's personnel are reluctant to take individual responsibility for approving a credit. They want to be sheltered from the perception that they could be making nepotism type loans which Moldovan banking laws prohibit and for which stiff criminal penalties are provided.

The process tracks as follows.

PRIOR TO SUBMISSION TO CREDIT COMMITTEE

- Loan Specialist prepares written loan analysis and recommends loan
- Chief credit officer reviews and approves
- Vice Chairman of credit reviews and approves
- Bank Attorney reviews for legal issues only
- Loan review specialist reviews all borrower data to assure accuracy and completeness.
- Chief Accountant reviews to assure funds are available to make loan

CREDIT COMMITTEE

- Chairman of bank
- Vice chairman
- Vice chairman
- Chief Credit Officer
- Chief Attorney

Note! Loans provided under the joint Bank/CNFA program also require the approval of CNFA prior to funding.

LOAN DOCUMENTATION ADEQUACY

An inspection was made of the document file for the first mortgage loan completed by FinCom under the FinCom/CNFA program in August 1999. I was able to determine what materials were gathered, evaluated and archived by the Bank in connection with the mortgage loan transaction. The file examined contained the following items:

- Loan Application
- Loan Agreement
- Mortgage Agreement
- Sale and Purchase Contracts
- Excerpt from real estate registry
- Title Certificates
- Property Description
- Enterprise Registration
- Financial Statements

- Correspondence to CNFA
- Approval from CNFA
- Loan Officer's submission
- Credit Committee approval
- Borrower's legal documents
- Decision of Real Estate Formation
- Land Lease Contracts
- Barter Contracts
- Business Plan
- VAT Registration
- Proxies from literate and illiterate sellers
- Various internal operational docs.
- Certificate of collateral registration

Based on the collateral and support information found in the file, the Bank has sufficient knowledge of the critical legal and underwriting issues and on how to analyze and perfect their collateral interests.

III. HISTORICAL PERSPECTIVE ON MORTGAGE LOANS AT FinComBank

The Bank has historically used BUILDINGS & IMPROVEMENTS as a source of collateral. In the majority of these transactions the loans have been structured primarily for general business purposes and liquidation of the property would be a secondary source of repayment. They looked to the business's operations as the principal repayment source. The other type loans for which BUILDINGS & IMPROVEMENTS have been taken is for the purchase of individual residential dwelling units in stacked multi tenant residential (apartment) complexes. In all cases, the borrower/pledgor never had direct ownership of the land, but only had a right to use the underlying land for a defined term. Per the Bank's written policy, commercial and production REAL ESTATE loans shall not exceed 50% of value and have a maximum term not to exceed 7 years. Terms under 5 years is more common. Residential REAL ESTATE loans are not to exceed 50% of value and be limited to a maximum term of 10 years. (Residential projects generally are multi-story buildings where individual land ownership would be impossible. Some form of condominium or cooperative legal structure will have to be established). In practice, residential mortgage financing is virtually non existent since individual incomes are insufficient to qualify for financing a typical residential unit at current market rates. Loan staff generally agree that the maximum term limitation places them at a disadvantage but management is not flexible considering the economic condition of the country and the instability of property values.

IV. GENERAL OBSERVATIONS

A <u>traditional</u> Commercial Real Estate Loan transaction is where the real estate (land together with all improvements) is the principal application and purpose of the loan and is where a bank looks to the operation of the property being financed as the primary cash flow source of loan repayment i.e. the real estate project is self supporting. This concept is unknown in Moldova and, accordingly, so is the analysis of such transactions. The development of traditional real estate loan and operating performance ratios is not a familiar subject. In the future, traditional mortgage financing will become an important tool in the arsenal of loan products that the Bank will provide. Property values will only be enhanced in that the value of the underlying land, unless severed via a ground lease, will be included in the overall property value.

Financing farm land is a unique concept in itself. It is not a traditional real estate transaction but is a kin to financing a business venture where the land itself produces the source of revenue. Accordingly, considerable information and understanding is required about the nature and properties of land and about the types of crops and yields it can produce.

The prime concern of individuals with whom I have talked regarding mortgage financing is -- **how** to value and treat land as a collateral source. Independent appraisal firms have no experience in valuing any type of land as an independent commodity nor have they considered the value of the land component in the appraisal of REAL ESTATE. Banks have not taken land as collateral in the past and are uncomfortable in assessing the risks associated with raw land, especially agricultural land. This is a legitimate concern since there are few and questionable market comparables to refer to and utilizing the economic approach in determining the land component of a farming business is nebulous since there are very little historical data to track regarding the financial and operating performances of individual farm entrepreneurs. In any event, land utilized in a farming operation can be treated like REAL ESTATE associated with any income producing business. Its value is dependent on the economic return it can be expected to provide. This is determined by the business's cash flow potential. Once a realistic gross income stream can be projected and the operating expenses tied down, a net cash flow residual analysis can be conducted to determine the land's estimated value. The most difficult task is estimating an income level that a farmer can sustain considering the factors in place in the Republic of Moldova. A few of the problems encountered in analyzing the stability of a farmer's income potential include: the lack of a stable cash based commodity markets into which products can be sold; the absence of viable local processing and storage facilities; the unavailability of capital which restricts farmers from the potential for extracting maximum yields from the land; lack of crop insurance, dependence on uncontrollable factors such as natural resources, and no governmental assistance.

V. MORTGAGE LENDING OBSERVATION ON THE INITIAL BANK LOAN

Except for the pilot program initiated by CNFA, no formalized purchase money type mortgage lending program has been available to farmers. One agricultural land based mortgage loan has been completed in August 1999 under the CNFA/FinComBank cooperative agreement and appears to have been handled satisfactorily. Recently, I visited the borrower at his farm in a village located about two hours drive north of Chisinau. The borrower indicated that he was pleased with the professionalism of and the treatment given to him by the Bank.

I reviewed the loan and on the whole found it acceptable. Underwriting issues were adequately addressed, the collateral was acceptable, and the borrower meets the targeted profile. I also reviewed the two principal loan documents that were prepared and used by the Bank in the actual loan transaction – The Contract on Pledge and the Loan Agreement (the mortgage and note, respectively). Although they were comprehensive and relative complete, I would recommend several modifications to each document. The Contract on Pledge needs (1) to emphasize the Bank's rights to accelerate, (2) to expand the covenants that trigger a default, and (3) to eliminate superfluous references to movable property. The Loan Agreement covers the debt obligations of the borrower and stipulates the repayment schedule. The Agreement provides for an adjustable interest rate throughout the life of the loan. Of major concern is that there is no quantitative method to adjust the interest rate or establish the revised periodic loan payments. Neither is there a provision for identifying an index to use as a basis for adjustment. The Agreement states that the Bank may adjust the rate for any micro or macro economic reason but the new rate must be agreed upon by the Parties. A fixed methodology with references to a publicly acceptable index must be established. When I discussed this issue with the Bank, their response was that based on their calculation algorithm, which is not disclosed, the interest rate paid by the borrower would not vary unless hyper inflation occurred. Under such circumstance, the borrower would have the option to repay the loan at a substantial discount. Another major issue is the Bank's requirement for the preparation of separate Notes representing each of the separate principal installment payments. The Loan Agreement called for these Notes but the Loan was funded without them in the hands of the Bank.

VI. GENERAL UNDERWRITING ISSUES

Normally, a bank would provide a loan in an amount less than 100% of the lower of value or cost. Under the circumstances, and considering the financial status of the typical borrower, 100% of cost may be justified if a substantially higher appraised land value level can be established. In no event should the advance exceed 75% of estimated value. Again, the major problem is establishing a realistic collateral value for the land. If the Bank is to lend an amount close to or equal to the actual cost of the property, borrower and financial factors must be given greater consideration than that of collateral value. The borrower should be experienced in producing and marketing their products; they should have generally good business acumen and be aware of financial matters, record keeping labor relations, and broad agronomic issues, and their farms should be of sufficient size to be an economically viable unit . From a commercial bank's perspective, the targeted customer should be the professional or the future professional farmer where long term business relationships can be developed. Small, independent family farmers should be able to seek financial assistance from alternative financing sectors. The Bank has indicated that they are not adamant on establishing a minimum loan amount but they are prepared to assess a nominal processing fee for loans under 20000 lei. They are also discussing using as an interim benchmark for determining market value, the average sales prices of all land parcels, sold and transferred, throughout the Republic and applying this number against specific land parcels. This is far too broad and unprecise to use as a legitimate valuation tool. More analysis in developing supportable market values is needed with input such as geographic location, topographic conditions, soil quality, market availability, transportation, natural or enhanced resources, etc. The Bank also mentioned to me that at the present stage of land privatization, they believe that farm lands are selling far below their "true" value and, as such, they are not overly concerned over the ratio of loan amounts in relation to the purchase price of the parcel.

VII. RECOMMENDATIONS

Short term-

Action: Develop uniform loan documents based on acceptable banking policies and current Moldovan laws, which can also be used by alternative mortgage lenders. **Responsibility**: BAH legal staff, the Bank, and Mortgage Advisor.

Action: Configure data base on closed farm land sales transactions which is currently complied by ELS into a form to assist in establishing normal market values. **Responsibility**: BAH and Mortgage Advisor

Action: Develop simplified business plan models and application forms that can be used by the typical client base.
Responsibility: BAH, the Bank, Mortgage Advisor

Action: Work on getting acceptable financial statements from clients that meet all legal and practical issues.
Responsibility: BAH, Bank, Mortgage Advisor

Action: Develop a comfort level on understanding the valuation process of agricultural property.
Responsibility: BAH, Mortgage Advisor, Valuation Advisor

Action: Develop acceptable underwriting policies for CNFA/Bank farm land transactions.
Responsibility: the Bank, Mortgage Advisor, BAH

Medium Term

Action: Develop training programs on understanding non-agricultural type commercial mortgage lending. Analyzing property cash flows, maximum loan amounts, operating ratios, etc.

Responsibility: Mortgage advisor

Action: Continue developing land market data.
Responsibility: BAH

Action: Streamline foreclosure processes. Develop a quick procedure with the off-set possibly being elimination of deficiency judgements. This could be a long term task because legislation may have to be implemented.
Responsibility: BAH legal team, Government of Moldova

Long Term

Action: Develop longer term affordable mortgages – 20 to 30 year terms.
Responsibility: Government of Moldova and National Bank of Moldova

Action: Develop laws to identify and permit condominium and private cooperative ownership.
Responsibility: Government of Moldova

Action: Generate greater availability of capital to invest into mortgages
Responsibility: Government of Moldova and National Bank

This will be dependent on attracting funds into the banking system, meaning developing public confidence in banks and the government.

Action: Develop a secondary mortgage market.

Once capital is available for mortgages, it will need to be sustained via a secondary market. This appears to be several generations away and if a market does surface, it would most likely be focused towards conventional residential mortgages. Before this can happen, several infrastructure elements would have to be developed. A proven, workable residential mortgage market will have to have been established and tested. Laws and governmental support for real estate and mortgages will be necessary; uniform repayment schedules and documentation will have to be established; mortgage insurance may have to be developed to mitigate against high LTV loans; and most important, there has to be sufficient volume of transactions to generate pools that would attract investors.